Supreme Court, U.S.
FILED
NOV 12 1988
JOSEPH F. SPANIOL, JR.
CLERK

(3)

No. 88-658

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Of Counsel:

NEIL F. HARTIGAN
Attorney General of the
State of Illinois
100 West Randolph Street
12th Floor
Chicago, Illinois 60601

EDWARD J. BURKE
RAYMOND J. SMITH *
MARY PATRICIA BURNS
Special Assistant Attorneys
General
BURKE AND SMITH CHARTERED
55 West Monroe Street
Suite 1800
Chicago, Illinois 60603
(312) 853-3230

* (Counsel of Record)

Attorneys for Respondent

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

19 pp

QUESTIONS PRESENTED

Petitioner's statement of "Questions Presented" violates the dictate of Supreme Court Rule 21.1(a) that questions should be expressed in the terms and circumstances of the case. No portion of the Seventh Circuit's *en banc* opinion can be construed as overruling the Court's holding in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). To the contrary, the Seventh Circuit embraced the decision and in applying it concluded that the unique factual and legal relationship between a publicly regulated natural gas local distribution company and its captive residential customers constituted a cost-plus contract within the meaning of the exception to the *Illinois Brick* rule.

TABLE OF CONTENTS

	PAGE
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	iii
OPINIONS BELOW	1
STATEMENT OF THE CASE	2
The Relationship Between CILCO, A Natural Gas Local Distribution Company, And Its Residential Customers	3
REASONS FOR DENYING THE WRIT	5
I.	
THE SEVENTH CIRCUIT'S DECISION IS CONSISTENT WITH THE COURT'S DECISIONS IN *HANOVER SHOE* AND *ILLINOIS BRICK*	5
II.	
THE SEVENTH CIRCUIT'S DECISION IS NOT IN CONFLICT WITH THE CIRCUIT CASES THAT HAVE APPLIED *ILLINOIS BRICK*	11
CONCLUSION	14
APPENDIX	(bound separately)

TABLE OF AUTHORITIES

Cases PAGE

Adickes v. S.H. Kress & Co., 398 U.S. 144 (1970) . 13
Arizona v. Shamrock Foods Co., 729 F.2d 1208 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985) 11
Blue Shield of Virginia v. McCready, 457 U.S. 465 (1982) 9
Equal Employment Opportunity Commission v. Federal Labor Relations Authority, 476 U.S. 19 (1986) 13
Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968) 9
Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977) . ..... *passim*
In re Beef Industry Antitrust Litigation, 600 F.2d 1148 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980) 10
In re Midwest Milk Monopolization Litigation, 730 F.2d 528 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984) 11
In re Wyoming Tight Sands Antitrust Litigation, 1988-2 Trade Cas. (CCH) ¶68,164 (D.Kan.), *appeal docketed*, No. 88-8042 (10th Cir. 1988) ... 11, 12
Jewish Hospital Ass'n v. Stewart Mechanical Enterprises, Inc., 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981) 12, 13
Mid-West Paper Products Co. v. Continental Group, Inc., 596 F.2d 573 (3rd Cir. 1979) 8, 11

Statutes

15 U.S.C. §1 2
15 U.S.C. §2 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Respondent State of Illinois respectfully requests that the Court deny the petition for writ of certiorari seeking review of the United States Court of Appeals for the Seventh Circuit's *en banc* opinion in this case.

OPINIONS BELOW

Subsequent to its ruling on July 18, 1988, but prior to publication, the Seventh Circuit corrected a misstatement in its *en banc* opinion. Petitioner's appendix at page A-1

does not set forth the corrected opinion. Accordingly, a copy of the Seventh Circuit's officially reported decision, at 852 F.2d 891 (7th Cir. 1988), is printed in Respondent's appendix at page R.App. 1; the correction appears at R. App. 12.[1]

STATEMENT OF THE CASE

In February, 1984, the State of Illinois ("State") filed the instant action against Panhandle Eastern Pipe Line Company ("Panhandle") alleging violations of Sections 1 and 2 of the Sherman Act.[2] 15 U.S.C. §§1, 2. The State sued both in its sovereign *parens patriae* capacity, and in its proprietary capacity as a gas consumer. Acting in this proprietary capacity the State also has been certified to represent a class of gas consumers residing in the geographic area of central Illinois served exclusively by Panhandle.

Panhandle owns and controls the only interstate pipeline that transports natural gas through Central Illinois Light Company ("CILCO") to the gas consumers within CILCO's service area. Panhandle, like most major interstate pipelines, is vertically integrated, owning extensive exploration, development and production affiliates. Panhandle sells

[1] "R.App." references are to the Respondent's Appendix.

[2] The State in its complaint alleges, *inter alia*, that Panhandle's conduct constituted an illegal (1) use of its essential facility; (2) tying of access to its transportation service to the purchase of its natural gas; and (3) monopoly leveraging of its power over transportation to obtain and maintain a monopoly over the sale of natural gas in the central Illinois market.

its own gas as well as gas it contracts for from other producers to CILCO's consumers. The complaint alleges that during the relevant time period abundant supplies of gas not under contract to Panhandle were available to gas consumers in central Illinois at a price substantially below that of Panhandle. The State's claims are based on Panhandle's refusal to transport any gas into the area except its own supracompetitively priced gas. As a result, Panhandle extracted from CILCO's customers well over 50 million dollars in anticompetitive overcharges.

The Relationship Between CILCO, A Natural Gas Local Distribution Company, And Its Residential Customers

CILCO is a publicly regulated retail distributor of natural gas. CILCO's service area covers sections of fourteen counties in central Illinois. It is a non-integrated pipeline in that it owns lines that are not connected to each other. Its main line, however, services 98 percent of its customers. The area covered by CILCO's main line is not served by any other natural gas local distribution company ("LDC"). CILCO's main line is connected to only one interstate pipeline, Panhandle.[3] Thus, as to the relevant portion of CILCO's service area the structure of natural gas distribution is simple: a single interstate pipeline, Panhandle, transports gas to the area and sells it to a single LDC, CILCO; CILCO then transports and resells the gas to its customers. CILCO, in short, is captive to Panhandle, and CILCO's customers are captive to it.

---

[3] The remaining two percent of CILCO's customers, who are not within plaintiff's class, are served by interstate pipelines other than Panhandle.

CILCO is regulated by the Illinois Commerce Commission ("ICC"). In 1982, pursuant to the Illinois Public Utility Act, the ICC promulgated the Uniform Purchased Gas Adjustment Clause ("Uniform PGA") applicable to all LDCs subject to its jurisdiction. The Uniform PGA is a mathematical formula that requires LDCs, such as CILCO, to fully recover their gas costs from their customers. Under the Uniform PGA an LDC has absolutely no discretion and must pass through to its customers 100 percent of its cost of gas; an LDC may not absorb one cent of its cost of gas sold.

During the period January 1, 1983 to the present, CILCO's filed tariff has contained a Uniform PGA provision whereby CILCO passes its cost of gas purchased from Panhandle through to its customers dollar-for-dollar. Each month CILCO makes a Uniform PGA filing with the ICC which sets forth Panhandle's gas charge. That gas charge is then passed through to CILCO's customers in its entirety as a separate and distinct component of each customer's bill. CILCO, therefore, recovers its exact cost of gas regardless of whether Panhandle's gas price increases or decreases. CILCO complied at all times with the Uniform PGA.

CILCO divides its customers into residential, commercial and industrial categories by virtue of its rates and tariff classifications approved by the ICC. An example of the clear distinction CILCO draws between its customers is reflected in its application to the ICC for approval of Rate 7. In 1983, certain of CILCO's large fuel-switchable industrial customers had available to them supplies of alternate fuel at a price below the regulated price of CILCO's gas. In order to meet this competition CILCO applied for Rate 7 which was expressly limited to this particular classification of customers. Under Rate 7, CILCO

obtained specific ICC permission to reduce for a four-month period its profit margin approximately 2¢ per therm on revenues derived from its transmission service. The Rate 7 reduction amounted to $935,527.15. At no time did CILCO seek a similar rate reduction for its residential customers. Those customers, unlike CILCO's industrial customers, did not have alternatives to CILCO's gas.

Petitioner in its "Statement of the Case", as it has in its briefs to the courts below, lumps together CILCO's residential and industrial customers and attempts to give the impression that CILCO's sales decreases were due to decreases in residential sales. This is misleading. For instance, in 1984 when CILCO's overall sales decreased 2.3 percent, its sales to residential customers actually increased 13 percent. Further, there is no evidence to indicate whether any decline in CILCO's sales was caused by price rather than other factors such as demographics, unemployment and weather.

REASONS FOR DENYING THE WRIT

I.

THE SEVENTH CIRCUIT'S DECISION IS CONSISTENT WITH THE COURT'S DECISIONS IN *HANOVER SHOE* AND *ILLINOIS BRICK*.

This case presents an extremely narrow legal issue within an unusual and narrowly circumscribed factual context. The problem concerns a group of residential purchasers of natural gas in Illinois who are the captive customers of a state regulated distributor, CILCO, that is in turn the captive customer of Panhandle, an interstate seller

and distributor of natural gas. The claim that underlies this suit is that since 1983 Panhandle has been charging CILCO a supracompetitive price for its gas. By virtue of state regulation of distributors of natural gas and CILCO's monopoly power over residential consumers, CILCO, as the Seventh Circuit found, was able to and did pass on to its residential consumers 100 percent of the anticompetitive overcharge without sacrificing any profits (R.App. 13).

The Seventh Circuit held that under these circumstances the relationship between the residential consumers and CILCO is a cost-plus contract within the cost-plus exception to the *Illinois Brick* rule (R.App. 13-14). *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). Petitioner asserts, however, that the Court in *Illinois Brick* directed that all cost-plus contracts must contain a fixed quantity term to be within the exception. Petitioner then argues that because such a term is absent here, the Court would decide that the damage claims of the residential consumers would be barred (Pet. at 11-14).[4] The Seventh Circuit analyzed both the rule and its exceptions, as well as the reasons that gave rise to those exceptions, and concluded that the Court's reference to a fixed quantity provision was not to require such a term as an independent element of a cost-plus contract, but was to explain that some factor was necessary in addition to an established price (*i.e.*, cost-plus) to ensure that the whole of the anticompetitive overcharge is passed through to the indirect purchaser without apportionment (R.App. 3-4, 12-13). The Seventh Circuit found that the factors present in this case provided that precise assurance (R.App. 13).

---

[4] "Pet." refers to the petition for writ of certiorari filed by defendant Panhandle.

As the Seventh Circuit recognized, the central fact of the *Illinois Brick* rule is that the direct purchaser who resells anticompetitively priced goods in a competitive market is likely to make the subjective pricing decision to absorb a portion of the overcharge in order to hold its customers. Where this occurs, the antitrust plaintiff—whether it be the direct or indirect purchaser—must reconstruct that subjective decision in order to trace the portion of the anticompetitive overcharge it bore. In order to avoid imposing on antitrust plaintiffs the burden of reconstructing the apportionment decision and at the same time avoid the danger of duplicative recoveries, the Court in *Illinois Brick* considered itself compelled to select between the direct and indirect purchaser as the appropriate party to pursue the antitrust violator. The Court selected the direct purchaser and ruled that in such cases the indirect purchaser may not sue for antitrust damages. In the Court's view, this course best promoted effective enforcement of the antitrust laws. *Illinois Brick*, 431 U.S. at 732-735.

The Court acknowledged, however, that there could be circumstances where the direct purchaser would not make the pricing decision to absorb some or all of the overcharge in order to hold its customers. In such circumstances, the reasons for the *Illinois Brick* rule are inoperative and indirect purchasers are not precluded from pursuing the antitrust violator. One general circumstance noted by the Court is where there is a cost-plus contract between the direct and indirect purchaser. *Illinois Brick*, 431 U.S. at 736. The Seventh Circuit held that the automatic fuel pass-through provision (the Uniform PGA) is such a cost-plus contract (R.App. 13-14).

Nevertheless, as the Court observed in *Illinois Brick*, even the direct purchaser armed with a cost-plus contract

might feel constrained to absorb a portion of the overcharge. This could occur where the direct purchaser's customers had alternative suppliers and could choose to decrease the volume of their purchases from it to avoid the anticompetitive overcharge. *Illinois Brick*, 431 U.S. at 736. This would *not* occur where the price term between the direct and indirect purchaser is regulated and where the indirect purchaser has no alternative to purchasing its entire supply from the direct purchaser (R. App. 7-9).

Thus, where the direct purchaser sets its price in a competitive, unregulated market, a fixed quantity term in a cost-plus contract fully relieves it of the necessity of deciding whether to absorb any of the anticompetitive overcharge; and in the absence of such a term, the basic *Illinois Brick* rule is applicable. *See, Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9 (3rd Cir. 1979). But here, CILCO's prices are the product of the particular Illinois laws that apply to distributors of natural gas and CILCO's monopoly power over its captive residential consumers. The Seventh Circuit considered these two factors—the presence of public utility regulation and the absence of competition—a "stand-in" for a quantity term present in the normal, privately negotiated contract (R.App. 8). CILCO could force the whole of the overcharge through to its residential consumers, and it did so (R.App. 7-9, 13). Accordingly, the Seventh Circuit held that the Court, applying *Illinois Brick*, would have selected the class of residential consumers as the appropriate party to sue for the damages they suffered as a result of Panhandle's misconduct (R.App. 14).

Petitioner argues that the Court's opinion in *Illinois Brick* prohibits a factual analysis, especially from an eco-

nomic perspective, as to whether a cost-plus contract exists (Pet. at 8-9). To the contrary, the Court's decision in *Illinois Brick* necessitates a factual analysis to determine whether it is " 'easy to prove that [the direct purchaser] has not been damaged;' " or in other words "that the overcharge has not been absorbed by the direct purchaser." *Illinois Brick*, 431 U.S. at 732, n.12, *quoting*, *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 494 (1968). In conducting this exact type of factual analysis, the Seventh Circuit did not rely on "simplifying economic assumptions," (Pet. at 14), but rather on facts easily determinable in the real economic world to conclude that: ". . . for every cubic foot of gas bought by a residential customer, we *know* that the whole overcharge was passed on to the consumers in accordance with the fuel pass-through provision of their contract with CILCO, and we know why (regulation plus the residential consumers' lack of alternatives)" (R.App. 13). As to these consumers, there was no absorption of the overcharge by CILCO. Contrary to petitioner's claim that *Illinois Brick* forbids *any* examination of the facts, what the Court sought to avoid was the use of hypothetical economic models, in cases where apportionment had occurred, to determine the extent of that apportionment. *See, Blue Shield of Virginia v. McCready*, 457 U.S. 465, 475, n.11 (1982).

Furthermore, as the Seventh Circuit found, because there was no apportionment of the overcharge, there is no danger of duplicative recovery (R.App. 9-11). The fact that CILCO filed suit against petitioner three years after the State's action was filed, over one month after completion of the State's 13-week trial on liability, and at a time when the statute of limitations had run or was about to run against CILCO, does not alter the conclusion. Un-

der the Seventh Circuit's rationale, as well as the symmetry and fairness principles articulated in *Illinois Brick*, because the CILCO-residential consumer relationship is within the cost-plus exception, petitioner will be able to successfully assert a *Hanover Shoe* pass-on defense against CILCO barring CILCO from pursuing any claim for the same overcharge.[5] *Illinois Brick*, 431 U.S. at 728-729.

If CILCO decides to pursue its action against petitioner, it will be able to seek damages for its alleged lost sales, but again the specter of duplicative recovery does not arise. The residential consumers are seeking, and have been allowed to sue solely for, the overcharge embedded in the *sales made*. Only CILCO can sue for its lost profits on the *sales allegedly not made* (R.App. 9-10). The damage to the residential consumers is distinct and in no way overlaps with the damage to CILCO (R.App. 10). *Accord, In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1164 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980), ("The middleman's loss of volume and the indirect purchaser's absorption of the overcharge are wholly separable items of damage."). Accordingly, as the Seventh Circuit found, while there may be more than one set of plaintiffs, each set will be suing in respect of different sales—not, as in *Illinois Brick*, the same sales (R.App. 10).

In sum, the Seventh Circuit's decision is not in conflict with *Illinois Brick* or *Hanover Shoe*; it does not overrule *Illinois Brick*, create a new exception to *Illinois Brick*, or expand the cost-plus exception recognized in *Illi-*

[5] By agreement of CILCO and Panhandle, Panhandle has not been required to answer CILCO's complaint, thereby avoiding the obvious conflict that would result between the position it advocates here and its assertion of the *Hanover Shoe* pass-on defense in that case.

nois Brick. The Seventh Circuit scrutinized the unique legal and factual relationship between CILCO and its captive residential customers and concluded that this particular relationship was a cost-plus contract within the exception to the *Illinois Brick* rule. The narrow scope of the Seventh Circuit's decision does not encompass every regulated industry; only the natural gas industry with the specific pricing regulation that mandates the pass-on of the overcharge. Nor does the decision embrace every natural gas consumer; only those who have no alternatives to the direct purchaser's gas.

For the reasons set forth above, the petition for a writ of certiorari should be denied.

II.

THE SEVENTH CIRCUIT'S DECISION IS NOT IN CONFLICT WITH THE CIRCUIT CASES THAT HAVE APPLIED *ILLINOIS BRICK*.

Petitioner attempts to mislead the Court when it states that the Seventh Circuit "concedes" that a conflict exists between its decision and the Third, Eighth and Ninth Circuits' cases which petitioner claims held that the cost-plus exception requires a fixed quantity provision (Pet. at 14-15), *See, Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9 (3rd Cir. 1979); *In re Midwest Milk Monopolization Litigation*, 730 F.2d 528, 533 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984); *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1212, n.2 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985).[6] The Seventh Cir-

[6] The only decision cited by petitioner, in actual conflict with the *en banc* court's decision is the district court's decision in *In re Wyoming Tight Sands Antitrust Litigation*, 1988-2 Trade Cas.

(Footnote continued on following page)

cuit made no such concession. The court had before it a "stand-in for the quantity requirement in an ordinary contract" and, therefore, expressly stated that it did *not* need to address the question of whether other cost-plus contracts, where such a term or stand-in was not present, were within the exception (R.App. 8, 14). In addition, the court distinguished the Third, Eighth and Ninth Circuits' cases on their facts, noting that each involved privately negotiated cost-plus contracts, whereas the CILCO-residential consumer relationship was governed by cost-plus contractual provisions required by state public utility regulation (R.App. 3).

Equally without merit is petitioner's claim that the Fifth Circuit's adoption of the "functional equivalent" approach, in contrast with the rejection of such an approach by other circuits, warrants review in this case (Pet. at 16-17). Even assuming that a conflict among the circuits exists, granting review in this case does not provide the Court with an opportunity to review that alleged conflict. The Seventh Circuit neither adopted nor rejected the functional equivalent approach, but stated explicitly that its decision was not dependent on such an analysis (R.App. 4-5). The Seventh Circuit did not need to rely on an "equivalent" because it found under these facts "the real McCoy"—a cost-plus contract (R.App. 5).

In seeking certiorari, petitioner also asserts that there is a conflict between the Seventh Circuit's decision and the Sixth Circuit's decision in *Jewish Hospital Ass'n v.*

---

[6] *continued*

(CCH) ¶68,164 (D. Kan.), *appeal docketed*, Nos. 88-8042, 88-8043 (10th Cir. 1988), where the district court, relying on the now vacated panel decision in this case, held that *Illinois Brick* barred a suit by residential consumers of natural gas.

Stewart Mechanical Enterprises, Inc., 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981), with respect to the "pre-existence requirement" (Pet. at 18). Petitioner for the first time cites *Jewish Hospital* for the proposition that the relationship between CILCO and its residential consumers lacks the "pre-existing relationship that insures in advance that the whole overcharge will be passed through" (Pet. at 18). This specific issue of whether the cost-plus contract must be in existence prior to commission of the anticompetitive conduct was not briefed or argued to the Court of Appeals and as the Court has often admonished, such a newly presented legal argument is not an appropriate basis for granting certiorari. *See, e.g., Equal Employment Opportunity Commission v. Federal Labor Relations Authority*, 476 U.S. 19, 24 (1986); *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 147, n.2 (1970).

The impropriety of asserting the lack of the pre-existing factor aside, petitioner's argument is merely its fixed quantity argument relabeled. In any event, all of the factors relied on by the Seventh Circuit to conclude that the CILCO-residential consumer relationship was within the cost-plus exception were in place prior to the anticompetitive conduct at issue here; namely, public utility rate regulation, including the Uniform PGA; CILCO's status as a monopolist; and the residential consumers' lack of alternatives.

Finally, petitioner contends certiorari should be granted because of the conflict between the majority of the *en banc* court and the dissenters (Pet. at 18-19). If petitioner's contention is valid, it leads to the absurd conclusion that certiorari would be appropriate in every circuit opinion in which a dissent is filed.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

EDWARD J. BURKE
RAYMOND J. SMITH *
MARY PATRICIA BURNS
Special Assistant Attorneys General
BURKE AND SMITH CHARTERED
55 West Monroe Street
Suite 1800
Chicago, Illinois 60603
(312) 853-3230

Attorneys for Respondent

* (Counsel of Record)

Of Counsel:

NEIL F. HARTIGAN
Attorney General of the State of Illinois
100 West Randolph Street
12th Floor
Chicago, Illinois 60601

Dated: November 14, 1988